



STATE WATER PROJECT CONTRACT EXTENSION PROJECT

Meeting Summary

State Water Project Contract Extension Project

January 22, 2014 10:00 AM – 4:00 PM

Draft Meeting Attendance List

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| <p><u>California Department of Water Resources Lead Negotiators</u></p> <ul style="list-style-type: none"> • Steve Cohen, California Department of Water Resources • Rob Cooke, California Department of Water Resources • Perla Netto-Brown, California Department of Water Resources • Vera Sandronsky, California Department of Water Resources • Carl Torgersen, California Department of Water Resources • Ralph Torres, California Department of Water Resources | <ul style="list-style-type: none"> • Jon Pernula (by phone), Palmdale Water District • Bob Perreault, Plumas County Flood Control & Water Conservation District • Jeff Davis, San Geronio Pass Water Agency • Ray Stokes, Santa Barbara County/ Central Coast Water Authority • Douglas Headrick, San Bernardino Valley Municipal Water District • Dana Jacobson, Santa Clara Valley Water District • David Okita, Solano County Water Agency |
| <p><u>State Water Project Contractor Lead Negotiators</u></p> <ul style="list-style-type: none"> • Dan Flory, Antelope Valley – East Kern Water Agency • Mike Wallace, Alameda County Flood Control Water Conservation District, Zone 7 • Paul Gosselin (by phone), Butte County • Valerie Pryor, Castaic Lake Water Agency • Mark Gilkey (by phone), County of Kings/Tulare Lake Basin Water Storage District • Tom Glover (by phone), Dudley Ridge Water District • Mark Krause (by phone), Desert Water Agency • Curtis Creel, Kern County Water Agency • Steve Arakawa, MWD of Southern California • Deven Upadhyay, MWD of Southern California • Kathy Cortner, Mojave Water District | <p><u>California Department of Water Resources Staff</u></p> <ul style="list-style-type: none"> • Ted Alvarez, California Department of Water Resources • Cathy Crothers, California Department of Water Resources • Terri Ely, California Department of Water Resources • Avery Estrada, California Department of Water Resources • Scott Jercich (by phone), California Department of Water Resources • Spencer Kenner, California Department of Water Resources • Kathie Kishaba, California Department of Water Resources • Philip LeCocq, California Department of Water Resources • Jeremiah McNeil, California Department of Water Resources • Mehdi Mizani, California Department of Water Resources |

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| <ul style="list-style-type: none"> • Dave Paulson, California Department of Water Resources • Nancy Quan, California Department of Water Resources • David Sandino, California Department of Water Resources • Lisa Toms, California Department of Water Resources • Dena Uding (by phone), California Department of Water Resources • Pedro Villalobos, California Department of Water Resources <p><u>DWR Consultants for Contract Extension</u></p> <ul style="list-style-type: none"> • Tom Berliner, Consultant • Stan Dirks, Orrick, Herrington & Sutcliffe, LLP • Erick Cooke (by phone), Environmental Science Associates • Cathy McEfee (by phone), Environmental Science Associates • Barbara McDonnell (by phone), MWH Global • Doug Montague, Montague, DeRose and Associates <p><u>State Water Project Contractors, and SWC, Inc.</u></p> <ul style="list-style-type: none"> • Josh Nelson, Best, Best & Krieger LLP/Crestline-Lake Arrowhead Water Agency • Royce Fast, Kern County Water Agency • Robert Kunde, Kern County Water Agency • Don Marquez, Kern County Water Agency • Amelia Minaberrigarai (by phone), Kern County Water Agency | <ul style="list-style-type: none"> • Ted Page, Kern County Water Agency • Jaime Dalida, MWD of Southern California • Kevin Donhoff, MWD of Southern California • David Reukema, MWD of Southern California • John Schlotterbeck (by phone), MWD of Southern California • Leah Wills (by phone), Plumas County Flood Control and Water Conservation District • Matt Naftaly (by phone), Santa Barbara County • Theresa Lightle, State Water Contractors, Inc. • Stan Powell, State Water Contractors, Inc. • Julie Ramsay, State Water Contractors, Inc. • Linda Standlee, State Water Contractors, Inc. <p><u>Public</u></p> <ul style="list-style-type: none"> • Dan McDaniel (by phone), Central Delta Water Agency • Thomas Rinn (by phone), Waterworks Consulting • Patricia Schifferle (by phone), Planning and Conservation League <p><u>Facilitation Team</u></p> <ul style="list-style-type: none"> • Macie Eng, Kearns & West • Mike Harty, Kearns & West • Kelsey Rugani, Kearns & West • Anna West, Kearns & West |
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I. Welcome/Introductions

There were roundtable introductions of the negotiation teams and staff attending in person and by phone. Members of the public were given the opportunity to introduce themselves.

II. Meeting Overview

Anna West welcomed everyone to the 18th negotiation session. She reviewed the ground rules and the action list and asked if there are additional edits to the January 15th negotiation session meeting summary. Hearing no objections, the meeting summary was approved and will be posted to the website.

III. Objectives Discussion

The Department's Next Offer Based on the SWP Contractor's 7th Offer

Carl Torgersen, DWR, reviewed the Department's latest Offer based on review of the Contractors' 7th Offer. Carl discussed the key changes.

Carl then asked for a clarification. Where it says State Water Contractors, Inc, he asked if it is intended to mean 29 Contractors or is it State Water Contractors, Inc. David Okita, Solano County Water Agency, confirmed that there were editing errors with a sentence in the footnote missing; he confirmed that the 7th Offer was from all 29 State Water Project Contractors.

Carl then explained that in Objective 1, Term of Contract, A. the Department added a section 2 to clarify the linkage to the Water Code and the Central Valley Project Act. Contractor attorneys will review this proposed language. Carl also explained that throughout the Offer, DWR changed "reimbursable costs" to "chargeable costs".

Carl explained that for Objective 2A: Reserves, item 1, the Department added "/or" so it reads "and/or." Also, on Objective 2A: Reserves, item 8 and thinking about the document, the Department changed the language from "non-water supply costs" to "costs not chargeable to the Contractors."

Carl also explained that for Objective 2A, Reserves, item 9, GOA Reporting, the statement about DWR providing written notice about General Operating Account (GOA) use was removed. In the future, DWR foresees using the GOA on a more regular basis for cash flow deficiencies and does not see the need to notify the Contractors on these more frequent cash flow uses. Carl suggested that in the event of an emergency and if a significant amount of funds are taken out of the GOA then all the Department and Contractors would be aware of these uses. Carl suggested that the Finance Committee could review and suggest a policy change if one is needed in the future.

Carl then explained that on III. Objective 2B, Accounts, item 5, SWRDS Reinvestment Account (SRA) Replenishment, the Department added "in addition to transfers from other accounts." Also, on item 6, SRA investments, item b. the Department edited the language changing it from "temporary financing" to "bridge financing of capital costs."

On Objective 2.B Accounts, A, SRA, item 5, SRA Replenishment, Carl described that DWR would like the SRA to be replenished by return of principal, interest and earnings on investments and transfers from other accounts. Carl explained further if it is determined that some funds are best allocated into the SRA from other accounts, DWR would like to be able to do so.

Deven Upadhyay, MWD of Southern California, asked if the notion on bridge financing of capital costs is to have bridge financing in place for a short period of time and then have DWR go out for a loan to repay that amount. Perla Netto-Brown, DWR, answered that the loan would be long-term. Curtis Creel, Kern County Water Agency, asked if bridge financing would act like the commercial paper program DWR has currently. Perla said yes, but if DWR had a bridge loan with SRA funds, the interest on the SRA could not be taken out with a revenue bond. She added that it is unlikely for DWR to use bridge financing in lieu of commercial paper.

Carl then explained that on Objective 2B, Accounts, B. SWRDS Support Account (SSA), item 2. SSA Uses, the Department deleted the language separating pre-2035 from post-2035, and also changed non-reimbursable to non-chargeable. Carl explained that the Department envisions that while most funds will be in the three accounts – GOA, SRA, SSA once funded and post-2035, there still may be revenues in the systems revenue account both pre- and post-2035.

Carl also explained that the edits to Objective 2B, Accounts, B. SSA, item 3, SSA Review, reflected the Departments edits to clarify that consultation occurs through the Finance Committee.

Carl explained that the Department left Objective 2B Accounts, B. SSA, item 9 on the SSA Backstop in for discussion. He explained that if the Department is comfortable with the overall AIP package, they may be comfortable with removing this backstop provision.

On Objective 2C, Flow of Funds, A.1., the Department added a sentence clarifying that annual rate reductions no longer apply after 2035 and therefore applicable 51 provisions will need to be deleted. Also, the Department removed the language on 2C Flow of Funds, A.3, on reconciliation since the Department will reconcile funds every year and the Director will maintain discretion over the amounts transferred across accounts. Therefore, Carl explained, the Department does not think this language is necessary.

On 2E, Supplemental Billing, Carl explained that the Department deleted the last sentence that stated that all cash balances would be exhausted. He explained that neither the Department nor the Contractors would want funds to be depleted of all resources leaving inadequate time for a supplemental bill to cover the cash needs.

Ray Stokes, Santa Barbara County/Central Coast Water Authority, asked if the Department has any proposals or ideas on what would result in needing a supplemental bill. Carl answered that a supplemental bill may occur if DWR reviews all accounts and determines that they do not have enough money to cover a specific, chargeable cost which would lead to the Department to determine that a supplemental bill is needed. Perla Netto-Brown, DWR, suggested that perhaps some of the language that DWR previously wrote for emergency billing could apply to supplemental billing. Perla clarified that supplemental bills will not be issued unless all other options are exhausted and it would be at a point where DWR would not be able to operate the State Water Project. Steve Cohen, DWR, added that removing or editing the supplemental billing provision since it is a provision in the Monterey Amendment could result in material adverse effects on bond holders.

Carl then explained that on Objective 3A, Simplification of Billing, B., item 3 on capital costs the Department deleted the language on agreement by the Contractors and he suggested that the Department is open to discussion with the Contractors.

Carl then explained that the Department removed X, Objective 3D, Billing Authorization and suggested that this item needs further discussion.

Reporting Principles and 51 (e) Reporting

Valerie Pryor, Castaic Lake Water Agency, then reviewed the Contractors' reporting requirements document. Valerie shared that the document is a general discussion paper about reporting principles recognizing that the actual reports may change over the contract term and therefore stating principles and not including specific reports makes sense. Generally, the Contractors envision the reports to be timely, accurate, and to inform the SWRDS Finance Committee's recommendations to the Director. In the document, Valerie explained that the Contractors outlined six reporting principles:

- Principle 1: Financial reporting will be generated from the general ledger or data warehouse of the financial information system (system of record), rather than being developed "off book."
- Principle 2: Financial reporting is not limited to annual financial statements, but will be developed for regular reporting periods.
- Principle 3: Financial reporting and financial management reporting will identify unusual items and exceptions, and these items will be documented, resolved and reviewed by management on a timely basis.
- Principle 4: Financial management reporting will identify and analyze significant variances from prior years or budgets.
- Principle 5: DWR will use standardized System-wide business rules and utilize a centralized financial system, such as SAP, to provide controls/validations to insure data integrity and reliable reporting.
- Principle 6: DWR will use standardized data integrity rules in the development and publication of reports, including but not limited to the following:

Deven Upadhyay then added that the Contractors may be willing to accept having 51(e) revenues within four accounts (GOA, SSA, SRA and the Systems Revenue Account) in the near-term if 51(e) revenues are accurately reported to the SWRDS Finance Committee. Deven elaborated that it is important to know if 51(e) revenues within the Systems Revenues Account can be treated as its own fund and also whether general accounting reports can be generated for the Finance Committee on these accounts. He explained that in the 51 (e) subaccount the Contractors would want to see revenues added over a time period, a list of expenditures that occur over a certain time period, and then a revenue balance to be able to determine if the fund and balance matches up. He explained that reporting should illustrate the totality of all 51(e) revenues coming into the Systems Revenue Account, when the revenues are used, what they are used for, and the starting and ending balance. Deven explained that the Contractors wanted to hear DWR's thoughts on this before putting this concept into writing.

Carl Torgersen responded that 51(e) revenue reports will definitely be generated for the Director and can be produced for the Finance Committee as well. He explained that the Director views it as essential to have complete transparency on these revenues so producing these kinds of reports should be acceptable to the Department. David Okita added that since 51(e) revenues

are derived from Contractor payments it is very important for the Contractors to provide input and understand how these funds are being used. Carl understood and asked if the Contractors' intent is to recommend specific report structures to the Finance Committee who can then recommend them to the Director. David answered that at this point, the Contractors wanted to see if there is agreement with DWR on the reports and to see if DWR has the ability to produce these reports and is willing to do so.

Carl Torgersen asked if the principles document would go verbatim into the contract and David answered that it would not. He explained that the Contractors are looking for feedback on the approach before getting into the details of implementation, or where the concepts would be memorialized.

Perla Netto-Brown asked if the principles are based on the Government Finance Officers Association of North America (GFOA)'s principles. Valerie answered that the principles were mostly generated by the Contractors and not the GFOA principles since those are broader. Perla said that most of the principles are in effect at DWR currently and that Carl has discussed enhancing reporting on numerous occasions. Carl added that he would need to talk to those generating the reports to make sure the specifics of the principles can be implemented. Carl reaffirmed how important transparency is important to the Director on 51(e) revenues and the accounts.

Ray Stokes asked if DWR could prepare a balance sheet for the 51(e) revenues that reside in the Systems Revenue Account using the SAP system. Perla answered yes as long as it is understood that the 51(e) revenues are projected and that charges occur on an annual basis. Perla elaborated that 51(e) revenues will be transferred into the four accounts twice a year when January and June payments are collected from the Contractors. DWR would perform a similar analysis they use to determine rate management credits to determine how much of the Contractors' payments are 51(e) revenues. Perla clarified that 51(e) revenue projections will be based on current year bills and not the previous year's revenues. Ray asked if there is an example of a current sub-account report that is similar to what the Contractors would like to see in a 51(e) revenues report.

DWR and SWP Contractors took a break for lunch and to caucus.

IV. Objectives Discussion Continued

After the lunch caucus, Carl Torgersen shared that the Department does not have significant disagreements with the Contractors' reporting principles. Carl said that the Department is following many of the principles currently and is working on implementing project management enhancements that will positively impact reporting. Carl explained that as a next step action DWR will review the document and propose edits, as necessary. Carl mentioned that further defining "timing" and "resolution" could benefit the document and its associated implementation. Carl explained that the Department's financial system includes a wide array of projects for operations, and it is important to consider what DWR can report timely and what may not be realistic. For example, Carl suggested that a construction project might have a very different time frame than other projects.

DWR and the Contractors agreed to hold a technical team meeting before the next negotiation session to discuss the kinds of reports that the Department can generate on the Systems Revenues subaccount with 51(e) funds. Perla mentioned that she might use the Facilities Capital

Account or the Replacement Accounting System (RAS) account as an example report of what the Department can produce.

State Water Project Contractors' 8th Offer

Then, David Okita reviewed the Contractors' 8th Offer that was developed during the lunch caucus. David described the following key points of the Offer.

For I. Objective 1, Term of the Contract, item 2, David asked for clarification on why this language was added. Steve Cohen stated that this Contract Amendment must be consistent with current terms that affect the bond holders and the Burns-Porter Act, and that this is especially important to focus on since new accounts are being established with different limitations. Steve explained that DWR has referred to this as the savings clause and how it is written in the Contract Amendment needs to be compliant.

David Okita explained that on III. Objective 2B, Accounts, A., SRA, item 5, the Contractors edited "other accounts" to specify "the SSA and/or GOA." David asked if the Department envisioned uses of any other accounts. Carl responded no, not at this time. David then explained that on III, Objective 2B, Accounts, A, SRA, item 6 on SRA investments the Contractors are fine with the 6.b. edits on bridge financing.

David Okita then explained that on II, Objective 2A, Reserves, the Contractors are largely OK with the Department's edits. On Item A.1, the edit "and/or" is fine. On item 8, GOA Replenishment, the Contractors deleted the last sentence since it appears to be redundant and not necessary. David further explained that on item 9, GOA Reporting, the Contractors added back in monthly reports and added that the balance and use of the GOA would be reported.

David Okita asked about the distinction between the terms chargeable and reimbursable; and why the Department made this change. Steve Cohen responded that the Department wanted to be consistent with the difference between non-water supply and water supply purposes and thought chargeable would be the most descriptive and accurate term rather than reimbursable. Jeff Davis, San Geronio Pass Water Agency, asked if chargeable is defined within the Water Code. Steve answered that chargeable is mentioned and described in the supplemental billing portion of the Water Supply Contract. Jeff asked if DWR defines chargeable as a broader term than water supply costs. Steve responded that he thinks water supply is a broader term. Carl Torgersen mentioned that the intent is still the same - that the Department will not charge the Contractors for anything that the Contractors cannot be charged for. Deven Upadhyay suggested that billing authorization language that is within the Water Code uses the terms non-reimbursable instead of chargeable. Carl suggested that the Department will review this further in their response to the Contractors' 8th Offer.

David Okita then reviewed Objective 2B, Accounts, B, SSA, the Contractors are OK with DWR's edits, including the 2. SSA Uses and 3. SSA review, however they wanted more discussion on how things are handled pre and post 2035.

Ray Stokes then asked why DWR envisions more frequent use of the GOA post 2035. Perla Netto-Brown answered that as DWR returns the artificial float back to the Contractors it is then

likely that a part of the GOA will be used to assist with cash flow timing differences. Perla explained that use of the GOA can assist in the event that DWR over-collects or under-collects from the Contractors. Ray shared that the Contractors are concerned with frequent use of GOA funds when the Contractors have understood that GOA funds would be used for large, unanticipated issues and/or emergencies. Perla explained that if the GOA is used in large amounts for emergencies DWR will follow policy and as emergencies arise, the Contractors will be aware of these uses.

David Okita then suggested that regarding Objective 2C, Flow of Funds, the Contractors want to see where there is agreement with the Department and where not. David shared that prior to 2035, the Contractors respect the Director's discretion to allocate 51(e) revenues amongst the GOA, SSA and SRA and the Systems Revenue Account with 51(e) funds. Through reporting, the Finance Committee will understand where the revenues are going and what revenues reside in the Systems Revenue Account. David asked if when the last 51(e) revenues are reconciled post-2035, will all of the revenues then reside in GOA, SSA and SRA. Perla clarified that the Department will no longer generate 51(e) revenues post 2035. She added that it is not the Department's intention to move all of the 51(e) revenues out of systems revenue post 2035. DWR proposes retaining the four accounts. Carl Torgersen said that the Director will still maintain discretion over any residual 51(e) revenues post 2035, but ultimately, residual 51(e) revenues will likely be exhausted. Ray clarified that post 2035, 51(e) revenues can be generated through interest on Systems Revenue. Carl said that the Director would have discretion over the interest.

Curtis Creel, Kern County Water Agency, said that the Contractors understand that post- 2035 Flow of Funds means that any remaining 51(e) revenues would ultimately be allocated into either the GOA, SSA or SRA. Pre-2035, the Contractors understand that some, but not all of the revenues would be allocated into the GOA, SSA and SRA while leaving some revenues in the Systems Revenue Account to allow for a transition period and to ensure that DWR is not over-allocating the total 51(e) revenues. He asked if this is DWR's understanding. Carl responded that in any year, the Director will maintain discretion over 51(e) revenues, and how much will be allocated between Systems Revenues 51 (e) subaccount, the GOA, SRA and SSA. Post-2035, Carl envisions the Finance Committee recommending to the Director whether to allocate remaining revenues that are in the Systems Revenues 51 (e) subaccount should go into the GOA, SSA or SRA. Carl added that management of 51(e) revenues will be transparent to the Contractors and DWR is open to hearing what reports will work for the Finance Committee.

David Okita then reviewed VI. Objective 2E, Supplemental Billing. He explained that the Contractors propose that supplemental billing can only occur when system cash balances are projected to be exhausted within 45 days. David asked if this addresses the Department's concern that they don't have to wait to bill until the accounts are empty. Carl said the Department will consider this provision in their review and development of the next offer responding to the Contractor's 8th Offer. Steve Cohen said that this provision would only exist for another 20 years, until 2035. Steve suggested that editing this provision in the Contract Amendment could have adverse effects on the bond holders. Ray Stokes said that the Contractors want to ensure that they are not sent a supplemental bill instead of DWR utilizing available cash and that a better definition of what would trigger a supplemental bill is needed. Steve responded that it is important to consider how this provision would be implemented in actuality. From his perspective, supplemental billing should stay in the Contract to be consistent

with the bond resolution. Carl said that DWR will discuss this topic internally. Kathy Cortner, Mojave Water Agency, added that supplemental bills could have adverse effects on the Contractors' already established budgets and already established annual rates. She noted that sending a supplemental bill after rates have been established can be quite problematic.

Deven Upadhyay said that he has heard many presentations about potential risk to bond holders and thinks that bond holders are interested in the totality of being able to cover DWR's costs and paying the bonds off. He suggested that the bond holders would consider the entire set of Contract Amendments when evaluating potential risk to bondholders and that includes the increased GOA and the establishment of the SSA and SRA which are positive developments regarding potential risk.

Regarding Objective 3D, Billing Authorization, Deven shared that the language here (the first three paragraphs) are from Davis-Dolwig and it outlines the Department's legal authority. Incorporating this language into the Contract ensures that the Contractors will not be billed for Davis-Dolwig costs. Carl responded that there are many places in the offer where DWR says they will not charge the Contractors for what they cannot be charged for. Carl Torgersen suggested that DWR will discuss this internally as part of its review and response to the 8th Offer from the Contractors.

After discussing the next steps for the Contractors' 8th offer, DWR and the Contractors began discussing the Agreements in Principle (AIP) process. Curtis Creel said that the offers will form the AIPs; the offers need to have enough detail so that it is easy to follow and can guide AIP language. Curtis added that the Contractors and DWR will need to determine what will go into the contract specifically. David suggested having some negotiators meet with attorneys to make sure they have what they need to word the AIPs correctly. From the DWR legal perspective, Steve Cohen shared that the offers as written provide significant guidance to draft AIPs; he doesn't see a lot of change being necessary. Carl added that there is a difference between agreeing on concepts and agreeing on actual language, so it is important to begin discussing the AIP process. David Okita mentioned that the Contractors will have to determine who will accept and sign the AIPs, whether it is the lead negotiators, their Boards of Directors, etc. David suggested that when the legal group meets to review the Finance Committee Charter binding language approach, they can also discuss the AIP process.

V. Next Steps

DWR and the SWP Contractors discussed the Contract Extension schedule and agreed the next meeting would be on Wednesday, January, 29th, and will go as long as possible to try to achieve closure on all topics. The group also agreed to schedule a meeting on Thursday, January 30th, if it is needed to achieve closure, if possible.

VI. Public Comment

There were no public comments.

VII. Adjourn

The meeting was adjourned.

| Action Items | Responsibility Due Date |
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| 1. | Draft January 22, 2014 negotiation session meeting summary. |
| 2. | DWR to prepare a sample report for how 51(e) revenues would be reported, possibly with a current subaccount of the Systems Revenue Account (RAS or Facilities Capital Account, for example). |
| 3. | DWR and SWP Contractors to convene a technical group meeting to discuss 51(e) subaccount reporting. |
| 4. | DWR and SWP Contractors Legal group to discuss Draft Final SWRDS Finance Committee Charter binding language and approach, and the AIPs process. |
| 5. | DWR to prepare a revised Offer based on the SWP Contractors' 8 th Offer. |
| 6. | DWR to prepare a revised edited version based on to the SWP Contractors' Reporting Principles. |